APPENDIX H

Lloydy Luck, PRIVATE EYE, July 2, 1993 at 28

It is now just over a year since the prime minister's historic visit to the United States in which he accomplished a most desperate mission: to save Lloyd's of London from the prying eyes of US government investigators.

During his visit -- in the first week of June last year -- John Major beseeched President Bush to stop the burgeoning investigations by US government agencies into Lloyd's. For nearly a year the securities exchange commission (SEC) had been investigating Lloyd's manic recruitment of investors in the US during the boom years of the 1980s.

Lloyd's was protected during the recruitment by its long-standing exemption from strict US laws governing the issue of securities. Was the exemption legal, especially for the recruitment of "unsophisticated" investors (ie investors who have at their disposal less than $1 million? And if the exemption was not legal, what was to stop hundreds of American "names" recruited to Lloyd's syndicates which have now been stung by massive claims over asbestosis and pollution from suing Lloyd's for the reimbursement of their losses?

These were the questions being asked by the grim-faced men from the SEC, and others even grimmer. In October 1991 reports leaked out that the Federal Bureau of Investigation was "widening the net to examine the possibility that the American names were the victims of fraud when they were signed up by Lloyd's agents" (The Times, 3 October 1991). The senate investigations sub-committee was digging even deeper.

Nothing could have done more damage to Lloyd's than a mass of lawsuits following such investigations. The recruitment without strings, with immunity from prosecution and unlimited liability, of thousands of rich Americans had been crucial to Lloyd's development and survival. But as many of those new investors

faced ruin, Lloyd's chiefs observed with horror that prominent US politicians were clamoring for results from the SEC Investigations.

As early as December 1991, for instance, Senator John Dingell, chairman of the House energy and commerce committee, wrote to the head of the SEC, Richard Breeden, demanding answers to questions about the progress of the inquiry. By the time Major got to Washington, there was something approaching panic in the high Tory circles at the top of Lloyd's.

Carefully briefed about all these matters, Major argued with Bush that British law (which has already decided that the Council of Lloyd's owes no duty of care to its Investors) should prevail in all such cases, and that American law should not be invoked. Bush agreed at once. Almost without anyone noticing, the investigations were summarily stopped.

Major had struck a great blow for his party. No one knows better than he how much his government and his majority depends on Lloyds' staying in business, safe behind its pervasive legal immunities.

The pending penury of so many Tory MPs who are "names" at Lloyd's is constantly being mourned in the newspapers, but it is only fair to remember that not all of them have suffered. Some have shown great shrewdness in extricating themselves from unlucky syndicates in the nick of time.

The record of Roger Knapman, farmer/surveyor MP for Stroud, is outstanding. In 1986, the year before he entered parliament, he came off the notorious Fagan syndicate (540) which declared some $600 million losses in the following four years. In 1987, Mr. Knapman came off the Gooda Walker syndicates (298 and 164), and Hazel (190), both of which declared huge losses the following year.

APPENDIX I

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Cheryl B. Strauss, *Do US Investors Need More Foreign Listings?*, INVESTMENT DEALERS' DIGEST, Nov. 9, 1992

November 9, 1992

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HEADLINE: Do US investors need more foreign listings? The SEC says it won't fix what is already working, but the NYSE says it's not working well enough

BYLINE: By Cheryl Beth Strauss

BODY:

AS A BUDDING INVESTOR, Manish Chopra has more reason than most to consider international equities. Born in New Delhi, India, Chopra is an investment banking analyst at a Wall Street firm. Although he has poured some $10,000 into US stocks since January, he says he is wary of "completely depending on the performance of any one economy." Even his broker has urged him to invest in a multi-market fund consisting of a basket of foreign stocks.

But Chopra has decided to pass on foreign equities -- at least for the moment. One immediate reason: September's currency mess in Europe. On another level, though, Chopra is typical of many US retail investors who show an initial interest in "investing in the international market as some point," as Chopra says, but never quite reaching that point. The market seems too unfamiliar, too scary and too, well, foreign.

William Donaldson wants to end that collective hesitation. The chairman of the New York Stock Exchange wants to make it

easier for Chopra and other investors to add an international equity or two to a portfolio. Donaldson has put considerable muscle behind a drive to get more foreign listings on the Big Board. Indeed, Donaldson is forthright in saying "we want to consolidate our position as a global power and see foreign companies list here."

Do US investors want, or need, more foreign equities? The question is a good one, and the answer is surprisingly complex. Exchanges says that investors are clamoring for foreign stocks. They cite statistics compiled by the Securities Industry Association showing that US investors have increased their holdings of foreign stocks to roughly $150 billion currently, a 62% rise from 1990's $92 billion. By comparison, their holdings of US stocks increased only 25% during the same period.

Exchanges also cite the large "pink sheet," or off-exchange market, the exists in American Depository Receipts, the vehicle by which most foreign firms now trade in the US. Of 890 ADR programs in the US, only 195 are listed on an exchange, according to Joseph Velli, an ADR expert with the Bank of New York. The rest, he says, are traded on the pink-sheet market. The Big Board, naturally enough, wants to formalize that off-exchange market, and give it more transparency.

But there is a flip side to the NYSE argument. Institutional investors, who buy most of the foreign shares, already have significant access to international equities. Retail investors like Chopra may be vaguely interested, but that is far short of hard demand. Many observers see the new push as a direct result on the NYSE -- like virtually all exchanges -- casting about for new revenue streams.

Sara Hanks, former chief of the international corporate finance office at the Securities and Exchange Commission, says that the NYSE is acting out of "enlightened self interest," wanting to boost its bottom line. That bottom line is quite healthy -- thank you -- at the moment, but the Big Board does have reason to be concerned about future revenue resources.

Its specialist system -- even its trading floor -- have been criticized as dinosaurs in an age increasingly dominated by computerized trading. The NYSE cleanly missed perhaps the most important movement on Wall Street in recent years -- derivatives. Its customers, too, have displayed an increasing willingness to trade away from the exchange. The NYSE's share of consolidated tape volume has dropped from roughly 87% to 82%. In that same period, the share of the NYSE's biggest competitor, the National Association of Securities Dealers Automated Quotations (Nasdaq), climbed to 6% from 2%.

Nowhere, though, is the clash over foreign listings louder than in the collision between the world's biggest stock exchange and its equally powerful regulator, the SEC. On the surface, the issue is about disclosure. In their home markets, foreign firms issue far less information -- with far less frequency -- on their operations than do their US counterparts. The Big Board wants the SEC to relax those rigid standards to allow "world class companies" like Germany's Daimler-Benz and the UK's Rolls Royce, to be able to list on a US exchange without having to overhaul their accounting procedures.

On a deeper level, though, the struggle may be about something more fundamental. If the SEC allows even a few exceptions to reporting standards, some believe, then its whole mandate may be open to question. Some observers say it is not the SEC's role to attract business for the exchanges -- no matter how much they may come to need it -- and that the SEC should stick purely to matters regulatory.

"How can the SEC give in and taint themselves," asks Merton Miller, a Nobel Prize winner and professor of economies at the University of Chicago, "anymore than the Windsor family of England could let King Edward the VIII marry a commoner, especially one who is also a divorced woman and an American?"

Both Donaldson and SEC chairman Richard Breeden deny that a clash exists. "There is no impasse," declares Breeden. "In the past few years, we have had more foreign issues registered here

than on any other planet." While the number of foreign issuers on the London Stock Exchange has decreased by 10 over the past three years, Breeden says, that the US marketplace has increased by 139. He concludes: "We don't care to exchange a system that has been overwhelmingly successful."

But change is exactly what Donaldson wants. While the NYSE chairman denies any sort of rift between the NYSE and the SEC, in the next breath he says that US investors are "missing out on some 2,500 foreign companies that would qualify to list on the NYSE that are 20 times the size of the average prospect here."

And the NYSE point of view is not without its supporters. Jonathan Auerbach, head of JI, Auerbach & Company, a broker/dealer firm specializing in international securities, contends: "The SEC is making prohibitive regulatory requirements, and our capital is being exported."

Which side will win? This issue, like so many on Wall Street, will be hugely affected by President-elect Clinton's victory, and the more than 100 new faces that will comprise the 103rd Congress. A new Administration will quite likely mean a new head of the SEC. But regardless of politics, many believe it's only a matter of time anyway before the SEC is forced to alter its stance.

"The American government will not sit forever and bar the NYSE from bringing foreign securities to the Big Board," says Edward Fleischman, a SEC commissioner who resigned in March of this year and is now an attorney with Rosenman & Colin. Fleischman, who had more than his share of run-ins with Breeden in his SEC days, says he told an NYSE lobbyist in Washington that the "majority of [SEC] commissioners are with you, but the chairman is against you." Donaldson, he notes, will still be there when Breeden is gone.

While Donaldson, Auerbach and others on Wall Street couch the issue in terms of US competitiveness, the institutions -- which comprise two-thirds of the daily trading volume on the

NYSE -- really aren't having a problem competing. Institutions already have far better access to foreign stocks than US retail investors.

For starters, institutions obviously have ample funds to invest abroad directly with a foreign broker, and to maintain a foreign account. Second, they have access to research on foreign firms both from Wall Street houses and their own internal research operations. And third, within the US, institutions are privy to a bifurcated private placement market that excludes retail investors, namely Rule 144A.

Developed by the SEC, 144A came to Wall Street with much fanfare. It has done well in debt markets, and fizzled in equity markets. Introduced in April 1990, 144A recognized that sophisticated investors should be able to buy and sell unregistered securities. Most foreign stocks are not registered with the SEC.

The rule has clearly and completely failed to develop a secondary market for unregistered foreign equities. Instead, 144A equities have become a phone-traded market in the US, but frequently with vibrant markets in the underlying stock in the country of origin. "The securities are being sold back to their home market," says Hanks, the former SEC international corporate finance official.

There are compelling arguments for buying a security in its home market. By opting for an original security over an ADR or 144A security, an institution can bypass the 15% withholding tax on foreign dividends. Also, institutions wanting to match fund liabilities may prefer to keep their foreign holdings in the home currency. Thus, even with increased foreign security access to US exchanges, there is no guarantee that a greater percentage of institutional activity would be conducted in dollars on the NYSE.

Think pink

Many Wall Street pros lament that the greatest marketplace for foreign securities in the US is also the least regulated: the

so-called "pink sheet" market. Only 22% of the 890 ADR programs for foreign securities in the US are exchange-traded, and the rest are pink-sheeters, according to the Bank of New York's Velli.

NASDAQ even has an over-the-counter bulletin board that is, in effect, an automated pink-sheet market. "Everybody buys on this market," Velli says. "It is both retail and institutional."

Since ADR prices are determined by the conversion price multiplied by the price of the actual share in the home market, there is not much variation between the price of an ADR on the pink-sheet market and on an exchange.

"It is important to recognize the size of the unregistered ADR market," says David Domijan, an executive vp in charge of new listings at the NYSE. "Over $1.6 billion worth of ADRs in the US are not listed with SEC, don't provide GAAP [Generally Accepted Accounting Principles] finances, and are traded in a less transparent, unregulated market. These companies are forced to go through intermediaries or pink sheets. It is a detriment to the US investor."

"GAAP is holding us up," adds Donaldson, the NYSE chairman. The result, he claims, is that the "American investor is buying the stock anyway in markets that have wider spreads and that cost 8% to 10% more."

As it turns out though, the pink sheet ADR market serves a couple of very useful purposes. Some foreign companies may be reluctant to register in the US without testing demand for their securities. "[They] use the pink sheet market as a stepping-stone market," says Velli.

These foreign companies go through only the rudimentary level one ADR disclosure procedures to trade in the pink-sheet market. Typically, after any anywhere between six months and five years, level-one ADR firms move up the ladder to level two, and list on an exchange.

Over the last three to five years, some 10% to 60% of level two-listed ADRs started off as level-one pink sheeters, according to Bank of New York statistics. Some of the better-known firms that have made that trip in the past two years include: Elf Aquitaine of the UK, now listed on the NYSE; Wellcome PLC, also from the UK and now listed on the NYSE; Microfocus, a British computer software company listed on NASDAQ; and Medeva, a UK pharmaceutical company listed on the American Stock Exchange.

Even today, some of the most active ADRs in the US still reside on pink-sheet rolls, names like Volkswagen AG of Germany and Rolls Royce of the UK.

The institutional edge

Besides the pink-sheet ADR market, retail investors have considerably fewer choices than institutions when it comes to international equities. Retail investors aren't privy to most Wall Street research. They generally can't afford a separate foreign broker or account. The currency issue is a hassle. So, too, is the relative lack of disclosure for foreign firms compared to the US.

That leaves, for most retail investors, a country fund or a listed ADR as the only other options. In a country fund, a manager purchases a basket of stocks originating in a particular country. The investor is generally stuck with using an intermediary, or broker, because of the lack of information about foreign companies' financials.

Done correctly, this can help both the investor and the broker. "Retail brokers," says Junius Peake, chairman of The Peake/Ryerson Consulting Group and a former member of the board of governors at the NASD, "would get nailed with unsuitability charges if they recommended some obscure foreign stock to their investors, because they wouldn't be able to defend themselves with consistent information about the companies that they're selling you."

Finally, there are the level-two ADRs -- foreign stocks that are actually traded on a US exchange. "ADRs are popular," says Smith Barney, Harris Upham & Co. broker Mark Freeman. "Clients don't necessarily want to invest in country funds because they don't want to pull all their eggs into one basket." The downside, though, of exchange-traded ADRs, "is the 15 percent withholding tax on foreign dividend," Freeman notes.

Although Freeman has seen client interest grow -- especially in Mexican stocks -- over the past three years, less than 10% of his 200-plus clients have actually chosen to invest in foreign stocks. Those clients who invested in Mexico though, have "seen staggering returns, multiples upon multiples on their money," he says.

Even the 10% figure, though, may overstate the degree of interest. Walter Haddad, a PaineWebber Chairman's Council broker -- a producer who is in top 1% of the company in terms of bringing in gross commissions greater than $ 1 million -- states flatly that he has seen no interest in foreign stocks from his clients. "They don't ask me, and I rarely bring the topic to them," he says.

The disclosure issue

Clearly the biggest hurdle to increased foreign listings on US exchanges is that of disclosure. Every country requires a firm headquartered within its borders to disclose a certain amount of information about its finances. The US, as SEC chairman Breeden never tires of pointing out, has the highest standards -- "100% disclosure," he says. As for other countries, Germany clearly has the most contentious accounting standards.

Germany has long followed the use of "hidden asset reserves" to smooth out financial bumps, according to Nick Platt, a managing director of investment banking and international marketing at the American Stock Exchange. German companies don't have to disclose their cash reserves; they often use this money to bolster their net income and smooth out earnings bumps. This practice can turn losses into gains, making a true financial

snapshot of a firm's condition at any given time a matter of guesswork, at least to a degree.

"[German] companies will never be listed on a major exchange as long as I live," Platt says. He doesn't see American disclosure standards relaxing to accommodate German firms anytime soon, or vice versa. "I don't think that the SEC will loosen up the listing standards to trade outside US GAAP requirements. It would look like it wasn't doing its job," he concludes.

While Platt's view has a significant following, so does that of Bill Donaldson. "We must," says the NYSE chairman, "reach agreement to let foreign companies come in with less than total conformity. What we are saying is that other fully developed countries' systems of ideas and sense of conservatism should be recast into American terms."

As for the German reserve issue, "the Germans have better flexibility for their companies to smooth out aberrations in their financials," Donaldson contends. Our own system of reserving, he correctly notes, is far from perfect. It is not uncommon for a US company, after years of less than adequate reserving, to "end up with a one-shot writedown," he says. "They how does the American investor understand what that action means about a US company?"

Mano a mano

The issue may be one of US competitiveness, as Bill Donaldson would have you believe, but it also is a showdown between two of the more important men on the US financial landscape. Ego and issue are, to some extent, intertwined.

Donaldson, as many point out, will still be at the helm of the NYSE despite the change in the White House. Breeden, on the other hand, has more limited choices. Clinton will probably choose a new SEC Commissioner more in line with his politics. But despite President Bush's loss, Breeden still needs to be

perceived as successful and vigorous to help him find work in the private sector once the new administration is firmly ensconced.

US investors take licks

In reality, the SEC stamp of approval means little more than a guarantee that a reasonable amount of information will be provided. US investors can and do get sucker-punched even with strong US disclosure laws.

Just last month, Chambers Development Co., according to published reports, had to restate earnings for every year since its founding in 1985; rather than big profits as reported, the Amex-traded waste management firm actually lost money each year. An overzealous management reportedly became obsessed with reporting profits no matter what the true results. American disclosure laws did not help Chambers' investors.

Chambers Development did not occur in a vacuum; the same story has recurred countless times on US exchanges, as it has on foreign exchanges. Yet foreign investors don't seem overly concerned about disclosure levels. "The German experience," says Nobel Prize-winning economist Miller, "suggests that people are willing to take their chances."

A hint of compromise?

One possible solution might be for the SEC to allow a completely bifurcated market -- which many people argue is actually the current state of affairs now because of the power that institutions command.

In such a marketplace, institutions would be able to buy and sell all foreign securities, knowing that the SEC has not cleared these companies but recognizing, as in 144A, that institutions are sophisticated buyers.

Shearson Lehman Brothers' head of international equities, Frank Masi, thinks such a solution makes sense. "There is more

and more institutional investment being made abroad," he says. "Whoever is there for foreign listings, NYSE or NASDAQ, can be a world marketplace."

The other possible solution -- which would include both retail and institutional investors -- is for US exchanges to list foreign securities with an asterisk next to them saying that they have not fulfilled all of the SEC's disclosure laws. But, again, the retail investor would end up being the party most at risk, and the retail investor is precisely the one that the SEC was created to protect.

GRAPHIC: Picture 1, Nobel Prize winner Miller: 'How can the SEC give in and taint themselves anymore than the Windsor family . . . could let King Edward the VIII marry a commoner?'; Graph, U.S. net purchases of foreign equities, Source: Securities Industry Association; Picture 2, SEC's Breeden: 'We don't care to change a system that has been overwhelmingly successful.'; Picture 3, NYSE's Donaldson: US investors are 'missing out on some 2,500 foreign companies that would qualify to list on the NYSE.'